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ORIGINAL ARTICLE

Risk externalities in a payments oligopoly

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Abstract I discuss the role to be played by central banks in payment systems by way of an oligopoly model of a payments market where firms exert negative risk externalities upon each other. A central bank participating actively in this market is modelled as benign in two ways: exerting less externalities than other banks and maximizing welfare rather than profit. Because other banks react strategically to the central bank's presence due to its low externalities, there is a risk that it backfires, with these other banks' taking more risky positions than if the central bank were not there. The proper role of the central bank may actually be to stay out.

Keywords Payments · Risk externalities · Interbank market · Mixed oligopoly · Central bank

JEL Classification G21 · D43 · E58 · L13

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